2007-05235/

THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE OCTOBER 2007

OVERVIEW

- In the second quarter of 2007 real gross domestic product (GDP) grew 3.4%, down from 3.9% in the first quarter but more than double the average pace of growth in the last three quarters of 2006.
- Domestic demand growth remained solid in the second quarter. Real final domestic demand rose 4.3% compared to 2.8% in the previous quarter. Consumer spending, residential investment and business fixed investment all showed healthy gains. Business inventory accumulation climbed to $4.8 billion from $3.2 billion in the first quarter.
- Real imports grew more than real exports, but improved terms of trade (the ratio of export to import prices) boosted the nominal trade surplus, raising the current account surplus (the amount that receipts from non-residents exceed payments to them). The current account surplus increased by $9.0 billion to $33.4 billion, rising to 2.2% of nominal GDP from 1.6% in the first quarter.
- Employment grew 1.3% in the second quarter, down from a 3.9% growth rate in the first quarter. In August the unemployment rate was 6.0%, the lowest level in nearly 33 years.

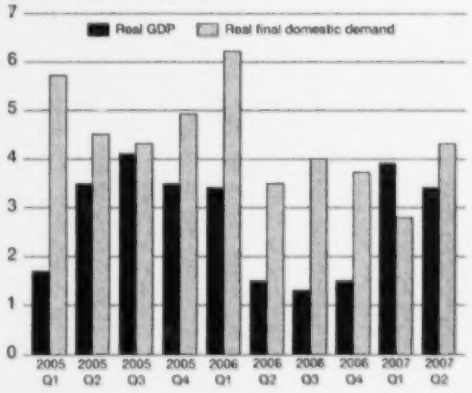
Real GDP increases 3.4%

Real GDP rose 3.4% in the second quarter of 2007 (Chart 1). Domestic demand growth strengthened. The increase in real final domestic demand outpaced that of real GDP for the 10th time in the last 11 quarters as real imports rose more than real exports.

Consumer spending stays healthy

Real consumer expenditure grew 4.9% in the second quarter of 2007, following a gain of 3.4% in the first quarter. Spending on durable goods (especially automotive products), non-durable goods and services grew faster than in the first quarter. Growth of expenditures on semi-durable goods, however, slowed.

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, September 20, 2007.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2005	2006	2006:Q4	2007:Q1	2007:Q2		Most recent
Real gross domestic product	3.1	2.8	1.5	3.9	3.4		–
Final domestic demand	4.5	4.7	3.7	2.8	4.3		–
Government expenditure							–
Goods and services	2.2	3.3	3.0	2.4	2.6		–
Gross fixed capital	10.9	8.1	4.1	-2.1	1.7		–
Consumer expenditure	3.8	4.2	3.7	3.4	4.9		–
Residential investment	3.5	2.1	-0.1	8.4	5.2		–
Business fixed investment	7.8	9.9	6.8	-1.2	4.1		–
Non-residential construction	9.8	12.9	11.8	3.6	2.2		–
Machinery and equipment	10.8	7.4	2.3	-5.5	6.1		–
Business inventory investment ($ billion)	13.5	10.2	0.1	3.2	4.8		–
Exports	2.2	0.7	2.7	0.8	2.9		–
Imports	7.5	5.0	-0.9	-0.4	6.4		–
Current account balance							
(nominal $ billion)	27.9	23.6	18.5	24.4	33.4		–
(percentage of GDP)	2.0	1.6	1.3	1.6	2.2		–
Nominal personal income	5.1	6.1	6.3	9.8	6.9		–
Nominal personal disposable income	4.3	6.4	5.6	8.8	3.4		–
Real personal disposable income	2.6	5.0	5.7	5.4	1.0		–
Profits before taxes	11.9	5.0	-0.8	9.0	4.7		–
Costs and prices (%, y/y)							
GDP price deflator	3.4	2.4	0.9	2.5	3.5		–
Consumer Price Index (CPI)	2.2	2.0	1.4	1.8	2.2	1.7	Aug-2007
Core CPI[1]	1.6	1.9	2.2	2.3	2.4	2.2	Aug-2007
Unit labour costs	2.6	3.1	3.6	3.5	4.6		
Wage settlements (total)	2.3	2.5	2.1	3.1	3.0	3.8	Jul-2007
Labour market							
Unemployment rate (%)	6.8	6.3	6.2	6.1	6.1	6.0	Aug-2007
Employment growth	1.4	1.9	2.4	3.9	1.3	1.7	Aug-2007
Financial markets (average)							
Exchange rate (U.S. cents)	82.6	88.2	87.8	85.4	91.1	99.87	20-Sep-07
Prime interest rate (%)	4.4	5.8	6.0	6.0	6.0	6.25	20-Sep-07

Note: Real values are in chained 2002 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

Personal income increased 6.9% in the quarter. Aided by gains in employment and the average wage rate, labour income climbed 7.6% after a 9.1% gain in the first quarter. Quebec government pay equity payments and contributions from the Newfoundland and Labrador government to its Public Service Pension Plan raised labour income in the first and second quarters. Real personal disposable income rose 1.0% and per capita real personal disposable income held steady. Given the strength in consumer spending, the personal savings rate was 1.8%, down from 2.7% in the first quarter.

Residential investment grows again and business investment rebounds

Residential investment rose 5.2% in the second quarter after a gain of 8.4% in the first quarter. The home resale market strengthened to record levels, boosting ownership transfer costs 19.1%.

New construction increased 3.0% after a gain of 1.1% in the first quarter. Spending on renovations increased 1.7%.

Business investment in plant and equipment grew 4.1% in the second quarter, rebounding from a decline of 1.2% in the first quarter. Spending on machinery and equipment registered a 6.1% gain after a 5.5% decline in the first quarter. The increase was concentrated in capital spending on automobiles and telecommunications equipment. Non-residential construction continued to rise, but at 2.2%, posted the smallest gain in the last 18 quarters.

Increased business inventory accumulation

Businesses added $4.8 billion to inventories in the second quarter, up from the previous quarter's $3.2-billion increase. Inventories of non-durable manufactured goods jumped while those of motor vehicles declined given increased automotive purchases by consumers and businesses. Given strong sales in the quarter, the overall inventory-to-sales ratio fell, matching its lowest recorded level.

Real imports increase more than real exports

Real exports increased 2.9% in the second quarter, a fourth consecutive quarterly gain. In goods trade, increased exports of energy, forest and industrial products were partly offset by reduced exports of machinery and equipment and automotive products. Exports of services edged up 0.6%.

Real imports grew 6.4% following a 0.4% decline in the first quarter. As a result, trade was once again a drag on growth after deviating from that trend during the previous two quarters, a trend coinciding with the appreciation of the Canadian dollar since 2002. In the quarter, all major import categories increased except automotive products. Imports of non-automotive consumer goods increased in line with strong consumer demand while imports of machinery and equipment rose as business investment strengthened. Imports of services increased 2.6%.

Current account surplus grows

Despite real imports exceeding real exports in the second quarter, the current account improved by $9.0 billion to $33.4 billion or 2.2% of nominal GDP, registering its 32nd consecutive surplus (Chart 2). A further appreciation of the Canadian dollar in the quarter continued to reduce import prices more than export prices, boosting the terms of trade. Export prices fell nearly 4% (annual rate) while import prices dropped more than 12%, raising the trade surplus by $7.1 billion.

Corporate profits show a healthy gain

Corporate profits rose 4.7% in the second quarter after a gain of 9.0% in the first quarter. Profits decreased to 13.6% of nominal GDP (Chart 3). While slightly below the peak at the end of 2005, this was well above the historical average of 10.3%. Stronger consumer spending boosted profits for retailers and wholesalers while higher mineral prices supported the mining sector. Profits in the manufacturing sector and the financial industry declined in the quarter.

Consumer price inflation eases but core stays above the inflation target

The GDP deflator, a comprehensive measure of prices, climbed nearly 6% in the second quarter, down from about 6.5% in the first. The increases in the GDP deflator were due to stronger terms of trade, higher consumer prices and the continued

Chart 2
Current account as a percentage of nominal GDP

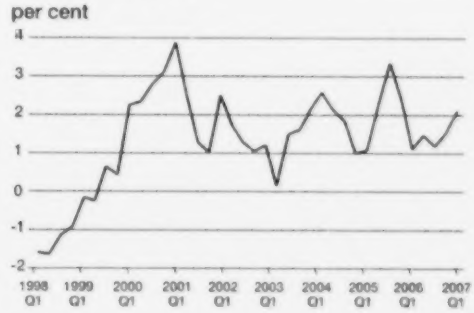


Chart 3
Profits before taxes as a share of nominal GDP

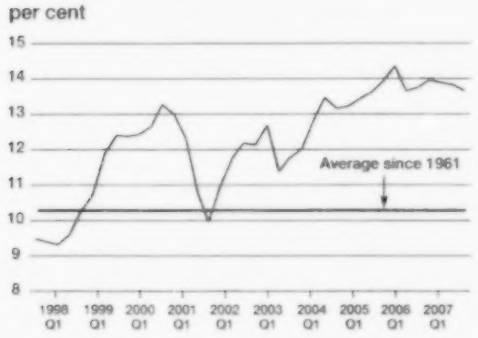
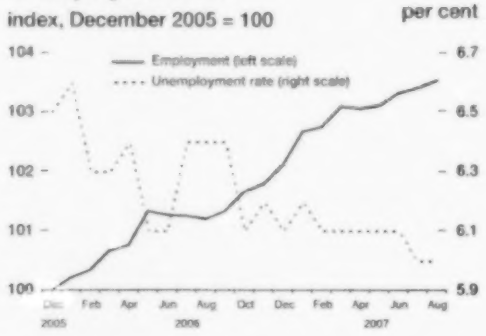


Chart 4
Employment and the unemployment rate



increase in the price of government goods and services due to the pension payments in Newfoundland and Labrador and the pay equity settlement in Quebec. The GDP deflator stood 3.5% higher than a year earlier.

Year-over-year consumer price inflation fell to 1.7% in August after four consecutive months at 2.2%, as gasoline prices declined. Core CPI inflation, which excludes the eight most volatile items and the effect of changes in indirect taxes, remained above the 2% inflation target, but declined to 2.2% in August from 2.3% in July.

Low unemployment rate

Employment grew 1.3% in the second quarter, a slower pace than the strong 3.9% gain in the first quarter. With further gains in July and August, net job creation stood at a healthy 578,000 since the end of 2005 (Chart 4). In August the unemployment rate was 6.0%, the same as in July and the lowest level in nearly 33 years. That followed five consecutive months at 6.1%. The participation rate stood at 67.5% in August, the same as in July and just below the record of 67.7% last seen in March.

Hourly labour productivity for the total economy grew 0.3% in the second quarter, down from the 2.5% pace of the previous quarter. Labour costs per unit of output on a total economy basis rose 4.9% in the second quarter, and are now 4.6% higher than a year earlier.

Bank of Canada holds policy rate steady

In response to credit market disruptions created by problems in the U.S. housing and sub-prime mortgage markets, on August 17 the U.S. Federal Reserve cut the discount rate by 50 basis points. On September 18, it lowered its policy rate from 5.25% to 4.75% and reduced the discount rate by another 50 basis points. On September 5, the Bank of Canada held its key policy rate—the target for the overnight rate—at 4.50% after raising it to that level on July 10. The July increase followed eight consecutive announcements that left the target rate unchanged. In the September announcement, the Bank judged "that the current level of the target for the overnight rate is appropriate." With core CPI inflation modestly exceeding the target, the Bank believes that the Canadian economy is operating above its production potential, but that adjustments in the U.S. housing sector and credit tightening could ease growth.

Higher energy prices, such as those for crude oil, boosted the value of the Canadian dollar. With world oil prices climbing to a record nominal dollar high of over $80 U.S. per barrel, partly in reaction to the cuts by the U.S. Federal Reserve, on September 20 the Canadian dollar closed at an over 30-year high of 99.87 U.S. cents.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Department of Finance Distribution Centre at 613-995-2855. For other inquiries about this publication, contact Isabelle Amano at 613-992-4321.
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